

Report
of the
Examination of
Clarno Mutual Insurance Company
Monroe, Wisconsin
As of December 31, 2002

TABLE OF CONTENTS

	Page
I. INTRODUCTION	1
II. REINSURANCE	5
III. FINANCIAL DATA	7
IV. SUMMARY OF EXAMINATION RESULTS	13
V. CONCLUSION	28
VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS	29
VII. ACKNOWLEDGMENT	30



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Jorge Gomez, Commissioner

Wisconsin.gov

May 16, 2003

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: information@oci.state.wi.us
Web Address: oci.wi.gov

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of
December 31, 2002, of the affairs and financial condition of

CLARNO MUTUAL INSURANCE COMPANY
Monroe, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1998 as of December 31, 1997.
The current examination covered the intervening time period ending December 31, 2002, and
included a review of such subsequent transactions deemed essential to complete this
examination.

The Summary of Examination Results contains elaboration on all areas of the
company's operations. Special attention was given to the action taken by the company to satisfy
the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on
February 16, 1874, under the provisions of the then existing Wisconsin Statutes. The original
name of the company was the Farmers Mutual Fire Insurance Company of the Town of Clarno.
Subsequent amendments to the company's articles and bylaws changed the company's name to
that presently used.

During the period under examination, there were two amendments to the articles of
incorporation and no amendments to the bylaws. Article I was properly amended in 1999 to

reflect the 1994 change of address of the home office. The change had not previously been approved by the policyholders or the Commissioner of Insurance. Article III was also amended in 1999 to state that the board shall be managed by at least six members but not more than eight members.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

Dane, Green, La Fayette, and Rock

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of one year continuous renewal, with premiums payable on the advance premium basis. Policy fees charged policyholders are retained by the company.

Business of the company is acquired through five agents, all of whom are directors of the company. Commissions are paid monthly on premiums paid, plus \$.30 per mile for travel allowance. Agents are presently compensated for their services as follows:

Type of Policy	Compensation
Property	8 %
Liability	12.5 %
Rural Renewals	\$20.00 each
City Renewals	10.00 each
Endorsements	1.50 each

Agents have authority to adjust losses of up to \$15,000. Losses in excess of this amount are adjusted by the adjusting committee. In addition, the adjusting committee reviews all claims at the monthly adjusting committee meetings. Adjusters receive \$15 for each rural loss adjusted and \$10 for each city loss adjusted, plus \$.30 per mile for travel allowance.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of at least six members but not more than eight members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Harvey Mandel*	Farmer/Agent	Juda, WI	2003
Beverly Stuckey*	Secretary/Manager	Monroe, WI	2003
Ted Falk	Farmer	Monroe, WI	2004
Dean Flannery*	Farmer/Agent	Argyle, WI	2004
Dean Signer*	Farmer/Agent	Monroe, WI	2005
James Roidt*	Bank Loan Officer	Monroe, WI	2005

Directors who are also agents are identified with an asterisk.

Members of the board currently receive \$35.00 for each meeting attended and \$.30 per mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

Name	Office	2002 Salary
Ted Falk	President	\$1,000
Dean Signer	Vice-President	0
Beverly Stuckey	Secretary/Manager	0
Harvey Mandel	Treasurer	3,000

The Secretary also receives a salary of \$26,500 as manager of the company.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The only committee at the time of the examination is listed below:

Adjusting Committee

Ted Falk, Chair
Dean Flannery
Dean Signer
Beverly Stuckey
Harvey Mandel
James Roidt

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
1998	\$302,885	\$180,978	824	\$42,053	\$1,771,036	\$1,407,066
1999	298,647	216,439	832	14,873	1,744,418	1,410,422
2000	328,563	111,812	859	66,826	1,934,210	1,512,554
2001	325,264	325,381	878	(33,155)	1,898,132	1,467,473
2002	330,850	129,851	880	88,462	1,918,740	1,518,817

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Gross	Ratios Net	Dividends Declared
1998	\$533,225	\$304,788	\$1,407,066	38%	22%	\$41,474
1999	552,586	304,395	1,410,422	39	22	40,526
2000	573,538	337,558	1,512,554	38	22	86,384
2001	577,196	325,739	1,467,473	39	22	0
2002	579,790	331,165	1,518,817	38	22	48,547

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
1998	\$180,978	\$94,343	\$302,885	60%	31%	91%
1999	216,439	104,160	298,647	72	34	107
2000	111,812	109,149	328,563	34	32	66
2001	325,381	124,948	325,264	100	38	138
2002	129,851	114,857	330,850	39	35	74

The above information shows that the company has generally experienced steady growth in policyholder surplus and has reported net income from operations in four of the five prior years. Policyholder dividends were paid in the years net income was earned. Although the company's loss ratio has fluctuated over the years, loss experience has been relatively favorable, and the expense ratio has remained low.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2003
Termination provisions:	Either the Company or the Reinsurer may terminate this Contract of Reinsurance and/or any of the attached exhibits as of 12:01AM Central Standard Time, January 1, 2004, or any subsequent January 1, by giving to the other party at least 90 days advance notice in writing.

The coverages provided under this treaty are summarized as follows:

- | | |
|----------------------|---|
| Type of contract: | Class A - Casualty Excess of Loss Reinsurance |
| Lines reinsured: | All business classified as Casualty business |
| Company's retention: | \$500 in respect to each and every loss occurrence |
| Coverage: | 100% of each and every loss occurring on the business covered by this contract, including loss adjustment expenses. Coverage is subject to maximum policy limits of \$1,000,000 per occurrence, in any combination of bodily injury and property damage liability, \$5,000 for medical payments, per person: \$25,000 per accident. |
| Reinsurance premium: | 75% of the premium written for each and every policy. |
- | | |
|----------------------|---|
| Type of contract: | Class B First Surplus Reinsurance |
| Lines reinsured: | All property business written by the company |
| Company's retention: | \$300,000 per ceded risk, plus at least 50% on a pro rata basis per ceded risk when the company's net retention is \$300,000 or less in respect to a risk. In any case the company shall retain an annual aggregate deductible equal to 10% of the loss and loss adjustment expenses otherwise recoverable. |
| Coverage: | Up to \$800,000 on a pro rata basis when the company's net retention is \$300,000 or more in respect to a risk. When the company's net retention is \$300,000 or less in respect to a risk, the company may cede on a pro rata basis up to 50% of such risk. |

Reinsurance Premium:	100% of the unearned premium applicable to property business. Pro rata share of all premiums and fees charged by company corresponding to the amount of each risk ceded.
Ceding Commission:	15% to 35%, depending on loss experience
3. Type of contract:	Class C-1 Excess of Loss - First Layer (Formula Rated)
Lines reinsured:	All property business written by the company
Company's retention:	\$35,000 per occurrence \$30,000 annual aggregate deductible
Coverage:	100% of any loss, including loss adjustment expense, in excess of \$35,000, subject to a limit of liability to the reinsurer of \$65,000
Reinsurance Premium:	Based on experience over the past four years with load factor of 125%. Minimum rate: 6.5% of current net premiums written Maximum rate: 21.4% of current net premiums written Current year rate is 7.69% Premium deposit: \$29,400 Minimum premium of \$24,000.
4. Type of contract:	Class C-2 Excess of Loss - Second Layer (Flat rated)
Lines reinsured:	All property business written by the company
Company's retention:	\$100,000
Coverage:	100% of any loss, including loss adjustment expense, in excess of \$100,000, subject to a limit of liability to the reinsurer of \$200,000
Reinsurance premium:	3.6% of the company's current net premiums written in respect to the business covered Premium deposit: \$13,800 Minimum premium of \$11,000
5. Type of contract:	Class D/E Stop Loss Reinsurance
Lines reinsured:	All business written by the company
Company's Retention:	75% of net written premium
Coverage:	100% of the amount, if any, by which the aggregate of the company's losses, including loss adjustment expenses exceed the retention
Reinsurance premium:	Current rate based on a formula calculation which takes into account the losses incurred by the reinsurer under this contract for the last eight years Minimum rate: 6.5% of the current net written premiums Maximum rate: 25% of the current net written premiums The rate for the current annual period is 6.5%. Premium deposit: \$26,400

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2002. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Clarno Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2002

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in Company's Office	\$ 21	\$	\$	\$ 21
Cash Deposited in Checking Account	93,079			93,079
Cash Deposited at Interest	1,313,362			1,313,362
Stocks or Mutual Fund Investments (at Market)	344,732			344,732
Real Estate	56,601			56,601
Premiums and Agents' Balances and Installments:				
In Course of Collection	(300)			(300)
Deferred and Not Yet Due	77,271			77,271
Investment Income Accrued		8,185		8,185
Reinsurance Recoverable on Paid Losses and LAE	3,212			3,212
Fire Dues Recoverable	623			623
Reinsurance Premium Recoverable	14,024			14,024
Other Assets:				
Expense Related:				
Reinsurance Contingent				
Commission Receivable	<u>7,930</u>			<u>7,930</u>
TOTALS	<u>\$1,910,555</u>	<u>\$8,185</u>	<u>\$ 0</u>	<u>\$1,918,740</u>

Liabilities and Surplus

Net Unpaid Losses	\$ 60,482
Unpaid Loss Adjustment Expenses	605
Commissions Payable	8,863
Federal Income Taxes Payable	8,964
Unearned Premiums	249,758
Reinsurance Payable	22,704
Nonexpense Related: Policyholder Dividends Payable	<u>48,547</u>
TOTAL LIABILITIES	399,923
Policyholders' Surplus	<u>1,518,817</u>
TOTAL	<u>\$1,918,740</u>

Clarno Mutual Insurance Company
Statement of Operations
For the Year 2002

Net Premiums and Assessments Earned		\$330,850
Deduct:		
Net Losses Incurred	120,032	
Net Loss Adjustment Expenses Incurred	9,819	
Other Underwriting Expenses Incurred	<u>114,857</u>	
Total Losses and Expenses Incurred		<u>244,708</u>
Net Underwriting Gain (Loss)		86,142
Net Investment Income:		
Net Investment Income Earned	<u>65,287</u>	
Total Investment Income		<u>65,287</u>
Other Income:		
Billing Fees	<u>5,580</u>	
Total Other Income		<u>5,580</u>
Net Income (Loss) Before Policyholder Dividends and Before Federal Income Taxes		157,009
Policyholder Refunds or Dividends		<u>48,547</u>
Net Income (Loss) Before Federal Income Taxes		108,462
Federal Income Taxes Incurred		<u>20,000</u>
Net Income (Loss)		<u>\$ 88,462</u>

Clarno Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2002

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	1998	1999	2000	2001	2002
Surplus, beginning of year	\$1,337,202	\$1,407,066	\$1,410,422	\$1,512,554	\$1,467,473
Net income	42,053	14,873	66,826	(33,155)	88,462
Net unrealized capital gains or (losses)	27,811	(11,517)	35,306	(11,926)	(37,118)
Surplus, end of year	<u>\$1,407,066</u>	<u>\$1,410,422</u>	<u>\$1,512,554</u>	<u>\$1,467,473</u>	<u>\$1,518,817</u>

Reconciliation of Policyholders' Surplus

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' Surplus per December 31, 2002, Annual Statement	\$1,518,817
---	-------------

Item	Increase	Decrease
Unearned Premium	\$20,434	\$
Accounts Payable	<u> </u>	<u>366</u>
Total	<u>\$20,434</u>	<u>\$ 366</u>
Increase to Surplus per Examination		<u>20,068</u>
Policyholders' Surplus per Examination		<u>\$1,538,885</u>

Reclassification Account	Debit	Credit
Commissions Payable	<u>\$ 2,225</u>	\$
Accounts Payable	<u> </u>	<u>1,969</u>
Unpaid Loss Adjustment Expenses	<u> </u>	<u>256</u>
Unearned Premium	<u>30,283</u>	<u> </u>
Advance Premium	<u> </u>	<u>30,283</u>
Total	<u>\$32,508</u>	<u>\$32,508</u>

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records - It is recommended that the company maintain complete board minutes including documentation of attendance, approval of dividends to policyholders, resignations of directors, yearly appointment of an adjusting committee, committee minutes and corporate decisions and standards.

Action—Compliance

2. Corporate Records - It is recommended that the company maintain the number of directors required by the company's articles of incorporation.

Action—Compliance

3. Corporate Records - It is recommended that any change in the articles of incorporation be amended in accordance with the articles and with s. 612.04, Wis. Stat., including approval by two-thirds of the policyholders voting and approval by the Commissioner.

Action—Compliance

4. Corporate Records - It is recommended that the company comply with s. Ins 6.57 (1), Wis. Adm. Code, by using only agents listed with the company after the receipt of the OCI validation report showing the agent is properly listed, and that the company implement procedures so that it only accepts business after receipt of the OCI agent validation report.

Action—Compliance

5. Corporate Records - It is recommended that the company file biographical data for new directors and officers on the required form with OCI within 15 days of such appointment or election, pursuant to s. Ins 6.52, Wis. Adm. Code.

Action—Compliance

6. Conflict of Interest - It is again recommended that the company directors, officers, and key employees annually complete conflict of interest disclosure forms.

Action—Compliance

7. Underwriting - It is suggested that the company have a formal inspection procedure whereby new applications and a sample of renewal business are inspected independent of the agent for the policy

Action—Compliance

8. Underwriting - It is recommended that the company follow the annual statement instructions, and that it accurately answer the general interrogatory for maximum probable fire loss.

Action—Compliance

9. Underwriting - It is suggested that the board establish written standards and documentation for the levels of reinsurance and the risks retained, and that each policy file have proper documentation showing how the ceded and/or retained amounts were determined.

Action—Compliance

10. EDP Environment and Disaster Recovery Plan - It is recommended that the company complete the development of a disaster recovery plan, and develop passwords to limit access to the computer.

Action—Compliance

11. Net Unpaid Losses - It is recommended that the company correct the deficiencies noted, and be in compliance with s. Ins 13.05 (3) (f) and (4) (e), Wis. Adm. Code, regarding accounting records and controls.

Action—Partial Compliance - see comments in the Current Examination Results section of this report under the caption, "Net Unpaid Losses".

12. Net Unpaid Losses – It is suggested that proof of loss forms be completed correctly, and that written procedures be developed for completion of the proof of loss

Action—Compliance

13. Net Unpaid Losses - It is recommended that the company adopt written procedures for regular review and follow up on open claims, that there be written documentation in the claim file on what is being done to settle a claim, and that the company adopt procedures for timely settlement of claims in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

Action—Compliance

14. Unpaid Loss Adjustment Expenses - It is recommended that unpaid loss adjusting expenses be included in this liability, that the liability include an estimate for all unpaid LAE, that documentation of when LAE is paid by claim is maintained, and that Schedule K be completed for unpaid LAE.

Action—Partial Compliance - see comments in the Current Examination Results section of this report under the caption, "Unpaid Loss Adjustment Expenses".

15. Unearned Premiums - It is recommended that the company comply with s. Ins 13.08 (4), Wis. Adm. Code, by requesting approval of the Commissioner to use the daily pro rata method to calculate the unearned premium reserve.

Action—Compliance

16. Accounts Payable - It is recommended that, in accordance with annual statement instructions, expense-related liabilities for unpaid obligations be included in the annual statement and on the proper lines.

Action—Partial Compliance - see comments in the Current Examination Results section of this report under the caption, "Accounts Payable".

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent period. The prior examination made several recommendations regarding corporate records. The company has complied with all the recommendations and has significantly improved its reporting and documentation procedures.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity Bond	\$ 100,000
Worker's Compensation:	Statutory
Employer's Liability:	
Each Accident	100,000 each accident
Each Employee	100,000 policy limit
Policy Limit	500,000 each employee
Commercial General Liability:	
Aggregate Limit	1,000,000
Products/Completed Operation	500,000
Medical Expense Limit	5,000 on any one person
Limit Per Occurrence	500,000
Fire Damage	100,000 any one fire
Personal and Advertising Injury	500,000
Building	102,000
Business Personal Property	15,000
Minicomputer	13,497
Blanket Limit	100,000
Professional Liability	
Company Professional Liability	1,000,000 per claim and aggregate
Directors and Officers Liability	1,000,000 per claim and aggregate
Deductible per Claim	5,000
Money and Securities	
On-Premises	10,000
Off-Premises	5,000

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. A sampling of new applications and of renewal business is inspected by the agents writing the business.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses. The adjusting committee consists of the board of directors, five of whom are also agents. Agent/directors are allowed to adjust claims which have an expected maximum loss of up to \$15,000. They are not required to be independent of the claims they adjust. Losses

greater than \$15,000 are adjusted by the adjusting committee, and all claims are reviewed by the adjusting committee before settlement. A review of the company's minutes indicates that the adjusting committee meets monthly, and committee members actively participate in adjusting losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2002.

The company is audited annually by an outside public accounting firm. The CPA firm employed by the company has been permitted to continue to issue audit reports on Clarno's financial statements despite the absence of partner rotation, pursuant to s. Ins 50.08 (2), Wis. Adm. Code.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computer is limited to people authorized to use the computer.

Company personnel back up the computers daily and the backed-up data is kept off-site.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has developed a disaster recovery plan.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

- (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
- (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

Investment Rule Compliance

The investment rule for town mutuals allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments.

Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1. Liabilities plus \$300,000	\$ 699,923
2. Liabilities plus 33% of gross premiums written	591,254
3. Liabilities plus 50% of net premiums written	565,506
4. Amount required (greater of 1, 2, or 3)	699,923
5. Amount of Type 1 investments as of 12/31/2002	<u>1,314,291</u>
6. Excess or (deficiency)	<u>\$ 614,368</u>

The company has sufficient Type 1 investments.

ASSETS

Cash and Invested Cash	\$1,406,462
-------------------------------	--------------------

The above asset is comprised of the following types of cash items:

Cash in company's office	\$ 21
Cash deposited in banks-checking accounts	93,079
Cash deposited in banks at interest	<u>1,313,362</u>
Total	<u>\$1,406,462</u>

Cash in the company's office at year-end represents the company's petty cash fund.

A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in one bank. Verification of checking account balances was made by obtaining confirmations directly from the depositor and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of 34 deposits in 17 depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2002 totaled \$66,190 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 3.25% to 7.1%. Accrued interest on cash deposits totaled \$8,048 at year-end.

Stocks and Mutual Fund Investments**\$344,732**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2002. Stocks owned by the company are located in a safety deposit box at a local bank.

Stock certificates were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Dividends received during 2002 on stocks and mutual funds amounted to \$13,225 and were traced to cash receipts records. Accrued dividends of \$137 at December 31, 2002, were checked and allowed as a nonledger asset.

Book Value of Real Estate**\$56,601**

The above amount represents the company's investment in real estate as of December 31, 2002. The company's real estate holdings consisted of the home office building.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Agents' Balances or Uncollected Premiums**(\$300)**

The above ledger asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. The account had a negative balance at year end due to endorsements reducing premium that had already been paid. A review of individual agent's accounts verified the accuracy of this asset.

Premium and Installments Booked but Deferred and Not Yet Due**\$77,271**

The above ledger asset represents premiums and agents' balances which are receivable, but not yet due because the insureds have chosen other than an annual billing mode.

This asset was documented by an automated report, itemizing the company's calculation of installments booked but deferred and not yet due for each policy in force as of December 31, 2002. The examiners' review of the entries on this automated report, which included recalculation of the company's results for policies selected on a sample basis, and review of the subsequent collection of the balance, verified the accuracy of this asset.

Investment Income Due and Accrued **\$8,185**

Interest due and accrued on the various assets of the company at December 31, 2002, consists of the following:

Cash Deposited at Interest	\$8,048
Stocks & Mutual Funds	<u>137</u>
Total	\$8,185

The examiner verified this amount by recalculating and tracing amounts to subsequent receipts.

Reinsurance Recoverable on Paid Losses **\$3,212**

The above asset represents recoveries due to the company from reinsurance on losses which were paid on or prior to December 31, 2002. A review of year-end accountings with the reinsurer verified the above asset.

Reinsurance Premium Recoverable **\$14,024**

The above asset represents recoveries due the company for the adjusted amount of reinsurance premiums. This amount is determined by calculating the annual premium due the reinsurer net of deposit premiums paid. Supporting records and subsequent cash receipts verified this item.

Fire Dues Recoverable **\$623**

This asset represents the fire department dues recoverable at December 31, 2001. The examiner reviewed the company's fire department dues calculation and found this asset to be correctly calculated.

Reinsurance Contingent Commission Receivable**\$7,930**

This asset consists of additional reinsurance commission due the company on the Class B-First Surplus contract. The amount is determined based on the loss experience of the company. Supporting records and subsequent cash receipts verified this item.

LIABILITIES AND SURPLUS

Net Unpaid Losses

\$60,482

This liability represents losses incurred on or prior to December 31, 2002, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule. Differences are reflected in the section of this report captioned "Reconciliation of Policyholders' Surplus."

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	\$137,000	\$119,247	\$17,753
Less:			
Reinsurance Recoverable on Unpaid Losses	<u>76,518</u>	<u>66,258</u>	10,260
Net Unpaid Losses	<u>\$ 60,482</u>	<u>\$ 52,989</u>	<u>\$7,493</u>

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2002. To the actual paid loss figures was added an estimated amount for those 2002 and prior losses remaining unpaid at the examination date. The examiner's actual development of unpaid losses indicated a \$7,493 favorable development as compared to the company's estimate. However, open claims still exist and the possibility for adverse development still remains, therefore no adjustment will be reflected for the positive development.

Although reserves for unpaid losses were sufficient, the prior examination recommended that an IBNR estimate for nonproperty losses be included in the annual statement for both the gross and recoverable amounts. Neither the current year nor the prior year annual statement included an estimate for IBNR nonproperty losses, although the current examination found IBNR nonproperty losses in both years. It is again recommended that the company include an IBNR estimate for nonproperty losses for both the gross and recoverable amounts when completing Schedule J-1 of the annual statement.

It was also noted that the company included the nonproperty adjusting expense reserve balance of \$9,423 in both nonproperty losses and nonproperty reinsurance recoverable on Schedule J-1 of the annual statement. The adjusting expense reserve balance should be

properly included on Schedule K, Lines 2a and 2c, Column 2. It is recommended that loss adjustment expenses for liability losses be included on Schedule K of the annual statement per Town Mutual Annual Statement Instructions.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

Unpaid Loss Adjustment Expenses

\$861

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2002, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is based on the number of claims not settled at year-end, as well as consideration of possible incurred but not reported claims and the related adjusting expenses.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be reasonably stated. However, it was determined that some expenses related to adjusting claims had been included in commissions payable at year-end. A reclassification entry was made reducing commissions payable by \$256, and increasing the unpaid loss adjustment expenses reported by the company by \$256, to reflect the actual balances at year-end. The company had originally reported unpaid loss adjustment expenses of \$605. The adjustment increased the balance to \$861. The prior examination also noted the liability for loss adjustment expenses payable was included in commissions payable. The prior examination recommended that the liability for unpaid loss adjustment expenses include an estimate for all unpaid LAE. It is again recommended that the

company properly classify commissions payable and loss adjusting expenses payable in the correct accounts according to Town Mutual Annual Statement Instructions.

Unearned Premiums

\$199,041

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology. The examiners' tests of the unearned premium balance determined that premiums received in advance of \$30,283 were not reported separately on the annual statement, but included in unearned premiums. A reclassification entry was made to decrease unearned premium and increase advance premium by this amount. It is recommended that advance paid premium be reported separately from unearned premium on the proper line of the annual statement in accordance with Town Mutual Annual Statement Instructions.

It was also determined that deferred installment premiums of \$6,653, received for January 2003, were double counted in the unearned premium computation. In addition, WRC reported \$13,781 as deferred premium ceded to the reinsurer. Because the company is no longer retaining this liability, it should not be included in unearned premium. An adjustment was made to reduce unearned premium by \$20,434 and increase surplus by this amount. The two adjustments reduced the company's reported unearned premium balance of \$249,758 by \$50,717 to \$199,041.

Reinsurance Payable

\$22,704

This liability consists of amounts due to the company's reinsurer at December 31, 2002, relating to transactions which occurred on or prior to that date.

Class A Liability Premium	\$5,875
Class C-1 Premium	2,400
Class C-2 Premium	1,350
Class D/E Premium	2,550
First Surplus Premium	12,387
First Surplus Commission	<u>1,858 Credit</u>
Total Due	\$22,704

Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Federal Income Taxes Payable **\$8,964**

This liability represents the balance payable at year-end for federal income taxes incurred prior to December 31, 2002.

The examiners reviewed the company's 2002 tax return and verified amounts paid to cash disbursement records to verify the accuracy of this liability. It was noted that the actual payment made was greater than the amount estimated at year end. The amount was not material so no adjustment will be made.

Commissions Payable **\$6,638**

This account consists of amounts due to agents for 2002 premiums. The company collects premiums directly from the insureds and then remits the commissions to the agents on a monthly basis. The review of the account balance noted that expenses related to salaries payable and meeting fees payable, as well as the unpaid LAE of \$256 noted previously, were included in commissions payable. A reclassification entry was made reducing commissions payable by \$1,969, and increasing accounts payable by that amount. A recommendation was made regarding this issue in the review of Unpaid Loss Adjustment Expenses. The two reclassifications reduced the company's reported commissions payable balance of \$8,863 by \$2,225 to \$6,381.

Accounts Payable **\$2,335**

This liability represents various expenses the company had incurred prior to December 31, 2002, which had not yet been paid. The balance of this account consists of a liability for miscellaneous expense items including payroll. The prior examination recommended that, in accordance with annual statement instructions, expense related liabilities be included in the annual statement and on the proper lines. It was determined during the current examination that, although the company has established separate accounts for individual expenses items to comply with the recommendation, the incurred but unpaid balances of salary and wages payable

and meeting fees payable were included in commissions payable on the annual statement. The reclassification entry of \$1,969 was noted in the review of commissions payable.

In addition, supporting records and subsequent cash disbursements also noted December incurred liabilities paid in January which were not included in accounts payable. Although the amount was not material, an adjustment will be made to increase accounts payable by \$366 and decrease surplus by \$366, as the prior examination included a recommendation on this issue. The reclassification of \$1,969 and adjustment of \$366 will increase the balance of accounts payable from the company's reported balance of \$0 to \$2,335. It is again recommended that expense related liabilities for unpaid obligations be included in the annual statement and on the proper lines in accordance with Town Mutual Annual Statement Instructions.

Premiums Received in Advance **\$30,283**

This liability represents premiums received for policies with effective dates in the subsequent year. The company reported \$0 on the balance sheet for this account. An examination of unearned premium noted \$30,281 of advance premium was included in the balance. A reclassification entry was made reducing unearned premium by \$30,283 and increasing premiums received in advance by the same amount. A recommendation concerning this account was made in the review of unearned premium.

Policyholder Dividends Payable **\$48,547**

The above liability represents policyholder dividends payable on 2002 business. The board of directors approved a 10% policy dividend on fire and E.C. in force premiums at year-end. The examiners' review of the calculation, and test of cash disbursement and in-force records, verified the reported liability. The policyholder dividends were approved at the January 16, 2003, board meeting.

V. CONCLUSION

Clarno Mutual Insurance Company is a town mutual insurer with an authorized territory of four counties. The company has been in business for 129 years providing property and liability insurance to its policyholders.

Since the prior examination as of December 31, 1997, the company has had increases to both net income and surplus in four of the prior five years. Surplus has increased by almost 8% to \$1,518,817. As a result of the company's favorable loss experience, the company has paid dividends to its policyholders in four of the five years under examination.

The prior examination resulted in thirteen recommendations and three suggestions. The company has addressed the majority of the problems noted and has significantly improved its reporting and documentation procedures.

The current examination resulted in five recommendations, three of which are repeated from the prior examination. The recommendations are listed in summary form on the following page.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 23 - Net Unpaid Losses - It is again recommended that the company include an IBNR estimate for nonproperty losses for both the gross and recoverable amounts when completing Schedule J-1 of the annual statement.
2. Page 24 - Net Unpaid Losses - It is recommended that loss adjustment expenses for liability losses be included on Schedule K of the annual statement per Town Mutual Annual Statement Instructions.
3. Page 24 - Unpaid Loss Adjustment Expenses – It is again recommended that the company properly classify commissions payable and loss adjusting expenses payable in the correct accounts according to Town Mutual Annual Statement Instructions.
4. Page 25 - Unearned Premium - It is recommended that advance paid premium be reported separately from unearned premium on the proper line of the annual statement in accordance with Town Mutual Annual Statement Instructions.
5. Page 27 - Accounts Payable - It is again recommended that expense related liabilities for unpaid obligations be included in the annual statement and on the proper lines in accordance with Town Mutual Annual Statement Instructions.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Sheur Yang of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

Jean Suchomel
Examiner-in-Charge